In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1,279

UNITED STATES OF AMERICA, PETITIONER

v.

IDEAL BASIC INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

1. The essential thesis of respondent's opposition to the petition for a writ of certiorari is the argument that (Br. 5) "the courts are in agreement as to the objective and the legal principles" of the proportionate profits method and as to "the technique to be used". And, respondent claims, the grant of certiorari would only involve this Court (*id.*) "in the details of the computation".

This, however, is a wholly inappropriate characterization of the questions presented in our petition. For the decision of the Tenth Circuit in this case wholly ignores the basic postulates of the proportionate profits method of computing the depletion allowance

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of an integrated miner-manufacturer and creates a wholly new method having no foundation in the statute or regulations.

As we have pointed out in more detail in the petition (pp. 7–9), the basic theory of a proportionate profits method is that every dollar of a miner-manufacturer's cost is deemed to produce the same proportionate part of the profits earned through sales of the first marketable end product. The theory requires that the miner-manufacturer's income from mining be determined by apportioning his gross receipts between the mining and nonmining phases of his operation in accordance with the ratio that his mining costs bear to overall costs. The initial step in the procedure is to classify each element of cost as a mining or nonmining expense. The basic premise of the method is that every element of cost must be characterized in this manner.

It is this last premise that the court below has abrogated in its decision to exclude post-manufacturing costs from the proportionate profits computation. And it is on this point that the decision below is in basic conflict with *Standard Lime & Cement Co.* v. *United States,* 329 F. 2d 939 (Ct. Cl.), and *Whitehall Cement Manufacturing Co.* v. *United States,* 369 F. 2d 468 (C.A. 3). In those decisions the Court of Claims and the Third Circuit made clear their view that post-manufacturing costs of shipping and marketing finished cement, such as those in issue here, bear no relation to a producer's limestone mining activities and therefore should be classified as nonmining costs. In result, under the reasoning of those two courts, these substantial post-manufacturing costs take their

proportionate share of income into the nonmining phase of the operation and accordingly reduce the integrated mining-manufacturer's depletion basis. On the other hand, even though the Tenth Circuit seems to recognize (see Pet. App. 6a–7a) the basic nonmining nature of these post-manufacturing costs, it has ignored the logic of this characterization. Rather, it has, in effect, allocated them ratably between the mining and nonmining phases of the operation, and thereby included in the depletion base part of the nonmining income attributable to these costs. Thus, far from involving simply "details", the Tenth Circuit's decision presents a substantially different method for determining the depletion basis of integrated miner-manufacturers and this approach cannot be harmonized with that approved by the Court of Claims and Third Circuit and set forth in the regulation.[1]

2. Respondent's effort to defend the decision below proceeds upon the assertion that respondent's (Br. 4)

[1] Respondent errs in asserting (Br. 3) that Treasury Regulations on Income Tax (1954 Code) Section 1.613–3(d) do not apply to its taxable year 1954 because they were not adopted until after this case was tried and that those regulations are materially different from the 1939 Code Regulations. Pursuant to powers granted in Section 7805(b) of the 1954 Code (see also Section 611(a)), the new regulations are expressly made retroactive, as their title indicates, to taxable years beginning after December 31, 1953. Further, as Section 1.613–3(d)(1)(ii) declares, the proportionate profits method "as described herein is merely a restatement of the method formerly set forth in the second sentence of Regulations 118, Section 39.23(m)–1(e)(3) (1939 Code)." As inspection of the regulations shows, this restatement reflects the interpretation of the 1939 Code Regulations in *Standard Lime* and *Whitehall Cement*—decisions which were retroactive without limitation—and gives such interpretation a uniform nationwide application.

"nonproducing costs * * * are different in kind from those incurred by other taxpayers who do not exclusively sell one mined-manufactured product such as portland cement and who might be required to allocate such costs among several products."[2] No attempt is made to explain this purported distinction and there is no basis for it. Regardless of how many products an integrated miner-manufacturer may sell, the proportionate profits method requires, as a first step, a division of *all* costs between the mining and non-mining phases of the operation. To be sure, if a taxpayer sells several distinct products, it may be necessary to allocate some post-manufacturing costs among more than one product. But this allocation can be made only after the cost is properly characterized as mining or non-mining. Thus the instant case may be one step less complicated than the application of the proportionate profits to a multi-product manufacturer would be, but the question in issue here—the proper characterization of post-manufacturing expenses—arises in exactly the same way and requires exactly the same resolution regardless of the number of products sold.[3]

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[2] Apparently petitioner's phrase (Br. 4) "nonproducing costs" is synonymous with "post-manufacturing costs". The phrase "nonproducing costs" has not been used heretofore in this litigation and is not a term of art having an accepted meaning within the industry. In consequence we can only conjecture at its meaning.

[3] Respondent's attempt (Br. 5–6) to defend the characterization below of bulk cement as its "first marketable product" is at odds with its characterization of itself as (Br. 4) "a single product producer of cement." If, as respondent

2. Respondent's discussion (Br. 6) of *Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16 (C.A. 9), entirely ignores that the Ninth Circuit quoted with approval a statement in the pertinent congressional committee report that a process (H. Conf. Rep. No. 20005, 86th Cong., 2d Sess., pp. 8–9) "is not treated as mining where applied to a purchased ore or mineral".[4] In this connection the court said (330 F. 2d at 18):

> We believe that by the enactment of the amendment in question Congress intended only to move the cutoff point from the crushing and grinding stage to the prekiln stage, but not to alter the revenue ruling with respect to separate computations of depletion of component minerals. To hold otherwise would be to allow a double depletion on the iron ore extracted by the taxpayer. This will not do.

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product apparently concedes, portland cement is the same product regardless of the quantities in which it is sold, the court below was plainly wrong in its holding on this point. In no event has respondent explained away the conflict on this point with the decision of the Third Circuit in *Whitehall Cement Manufacturing Co.* v. *United States*, *supra*.

[4] It is correct, as respondent states, that the Government conceded in the Ninth Circuit that the cost of (330 F. 2d at 18) "physically adding the quartzite and iron ore to the limestone" is not a cost of mining. That concession however, occurred solely at oral argument, and did not then and does not now represent the position of the government. We would submit that it is particularly persuasive for present purposes that notwithstanding the "concession" of a point not there in issue, the Ninth Circuit's rationale is entirely inconsistent with treating the cost of physically adding additives as mining costs.

CONCLUSION

The essential fact is that the decision below is in direct conflict with decisions of the Court of Claims and of the Court of Appeals for the [redacted] Circuit. The problem affects a substantial number of taxpayers, and, until this conflict is resolved, it is impossible for the Treasury to administer the statute in an equal manner. The petition for a writ of certiorari should be granted in order to settle the confusion and uncertainty resulting from these conflicting decisions.

Respectfully submitted.

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Solicitor General.

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